beginning on the first day of the taxable year in which he or she attains age 65 or, if mandatory retirement age is attained in an earlier taxable year, beginning on the day the taxpayer attains mandatory retirement age.

Q–17: *May a taxpayer who is eligible (see Q–4) to exclude disability income payments (without regard to the $15,000 phaseout explained in Q–5) under the new law begin to exclude applicable pension or annuity costs in an earlier taxable year?*

A–17: Yes, but such a taxpayer must make the election described in Q–18 and Q–19 in which case the taxpayer would no longer be eligible for the disability income exclusion.

Q–18: *What is an election not to claim the disability income exclusion?*

A–18: It is an irrevocable election for the taxable year for which the election is made, and each taxable year thereafter. If such an election is made the taxpayer will begin to recover tax-free, out of the payments, his or her annuity costs as provided under the applicable provision of the Code.

Q–19: *How does a taxpayer who is eligible to exclude disability income payments (without regard to the $15,000 phaseout explained in Q–5) under the new law make this election?*

A–19: The election is made by means of a statement attached to the taxpayer's income tax return (or amended return) for the taxable year in which the taxpayer wishes to have the applicable annuity rule apply. The statement shall set forth the taxpayers qualifications to make the election (i.e., that the taxpayer is eligible (see Q–4) to exclude disability income payments (without regard to the $15,000 income phaseout explained in Q–5)) and that such taxpayer irrevocably elects not to claim the benefit of excluding disability income payments under section 105(d), as amended, for such taxable year and each taxable year thereafter. The election cannot be made for any taxable year beginning before January 1, 1976.

Q–20: *Did the changes made by the Tax Reduction and Simplification Act provide any relief to taxpayers eligible for the sick pay exclusion in taxable years beginning in 1976?*

A–20: Yes. As originally enacted, the more restrictive provisions of the disability income exclusion applied to taxable years beginning in 1976. The Tax Reduction and Simplification Act postponed the effective date of these provisions for 1 year. Thus, taxpayers may claim the sick pay exclusion in taxable years beginning in 1976.

(Secs. 105(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1566; 68A Stat. 917; 26 U.S.C. 105(d); 7805))

[T.D. 7450, 41 FR 56630, Dec. 29, 1976, as amended at 42 FR 2954, Jan. 14, 1977; T.D. 7544, 43 FR 19655, May 8, 1978]

§ 7.105–2 Substantial gainful activity.

(a) *Purpose.* This section defines substantial gainful activity for purposes of section 105(d) and § 7.105–1, prescribes rules for determining whether a taxpayer has the ability to engage in substantial gainful activity, and provides examples of the application of the definition and rules in specific factual situations.

(b) *Definition.* Substantial gainful activity is the performance of significant duties over a reasonable period of time in work for remuneration or profit (or in work of a type generally performed for remuneration or profit).

(c) *General rules.* (1) Full-time work under competitive circumstances generally indicates ability to engage in substantial gainful activity.

(2) Work performed in self-care or the taxpayer's own household tasks, and nonremunerative work performed in connection with hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities is not substantial gainful activity. However, the nature of the work performed may be evidence of ability to engage in substantial gainful activity.

(3) The fact that a taxpayer is unemployed for any length of time is not, of itself, conclusive evidence of inability to engage in substantial gainful activity.

(4) Regular performance of duties by a taxpayer in a full-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity. For purposes of paragraphs (c)(4) and (c)(5) of this section, the minimum wage is the minimum wage prescribed by section 6(a)(1) of the Fair Labor Standards Act of 1938, as amended, 29 U.S.C. 206(a)(1).

(5) Regular performance of duties by a taxpayer in a part-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity, if the duties are performed at the employer's convenience.

(6) In situations other than those described in paragraphs (c)(4) and (c)(5) of this section, other factors, such as the

nature of the duties performed, may establish a taxpayer's ability to engage in substantial gainful activity.

(d) *Examples.* The following examples illustrate the application of the definition in paragraph (b) of this section and the rules in paragraph (c) of this section in specific factual situations. In examples 1 through 5, the facts establish that the taxpayers are able to engage in substantial gainful activity and, therefore, are not entitled to claim the disability income exclusion of section 105(d). In examples 6 through 9, the facts do not, of themselves, establish the taxpayers' ability or inability to engage in substantial gainful activity. In these situations, all the facts and circumstances must be examined to determine whether the taxpayers are able to engage in substantial gainful activity.

Example (1). Before retirement on disability, taxpayer worked for a hotel as night desk clerk. After retirement, the taxpayer is hired by another hotel as night desk clerk at a rate of pay exceeding the minimum wage. Since the taxpayer regularly performs duties in a full-time competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (2). A taxpayer who retired on disability from employment as a sales clerk is employed as a full-time babysitter at a rate of pay equal to the minimum wage. Since the taxpayer regularly performs duties in a full-time, competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (3). A taxpayer retired on disability from employment as a teacher because of terminal cancer. The taxpayer's physician recommended continuing employment for therapeutic reasons and taxpayer accepted employment as a part-time teacher at a rate of pay in excess of the minimum wage. The part-time teaching work is done at the employer's convenience. Even though the taxpayer's illness is terminal, the employment was recommended for therapeutic reasons, and the work is part-time, the fact that the work is done at the employer's convenience demonstrates that the taxpayer is able to engage in substantial gainful activity.

Example (4). A taxpayer who retired on disability, is employed full-time in a competitive work situation that is less demanding than his or her former position. The rate of pay exceeds the minimum wage but is about half of the taxpayer's rate of pay in the former position. It is immaterial that the new work activity is less demanding or less gainful than the work in which the taxpayer was engaged before his or her retirement on disability. Since the taxpayer regularly performs duties in a full-time, competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (5). A taxpayer who retired on disability from employment as a bookkeeper drives trucks for a charitable organization at the taxpayer's convenience. The taxpayer receives no compensation, but duties of this nature generally are performed for remuneration or profit. Some weeks the taxpayer works 10 hours, some weeks 40 hours, and over the year the taxpayer works an average of 20 hours per week. Even though the taxpayer receives no compensation, works part-time, and at his or her convenience, the nature of the duties performed and the average number of hours worked per week conclusively establish the taxpayer's ability to engage in substantial gainful activity.

Example (6). A taxpayer who retired on disability was instructed by a doctor that uninterrupted bedrest was vital to the treatment of his or her disability. However, because of financial need, the taxpayer secured new employment in a sedentary job. After attempting the new employment for approximately two months, the taxpayer was physically unable to continue the employment. The fact that the taxpayer attempted to work and did, in fact, work for two months, does not, of itself, conclusively establish the taxpayer's ability to engage in substantial gainful activity.

Example (7). A taxpayer who retired on disability accepted employment with a former employer on a trial basis. The purpose of the employment was to determine whether the taxpayer was employable. The trial period continued for an extended period of time and the taxpayer was paid at a rate equal to the minimum wage. However, because of the taxpayer's disability only light duties of a nonproductive make-work nature were assigned. Unless the activity is both substantial and gainful, the taxpayer is not engaged in substantial gainful activity. The activity was gainful because the taxpayer was paid at a rate at or above the minimum wage. However, the activity was not substantial because the duties were of a nonproductive, make-work nature. Accordingly, these facts do not, of themselves, establish the taxpayer's ability to engage in substantial gainful activity.

Example (8). A taxpayer who retired on disability from employment as a bookkeeper lives with a relative who manages several motel units. The taxpayer assisted the relative for one or two hours a day by performing duties such as washing dishes, answering phones, registering guests, and bookkeeping. The taxpayer can select the times during the day when he or she feels most fit to perform the tasks undertaken. Work of this nature, performed off and on during the day at the taxpayer's convenience, is not activity of a ''substantial and gainful'' nature even if the individual is paid for the work. The performance of these duties does not, of itself, show that the taxpayer is able to engage in substantial gainful activity.

Example (9). A taxpayer who retired on disability because of a physical or mental impairment accepts sheltered employment in a protected environment under an institutional program. Sheltered employment is offered in sheltered workshops, hospitals and similar institutions, homebound programs, and Veterans Administration domiciliaries. Typically, earnings are lower in sheltered employment than in commercial employment. Consequently, impaired workers normally do not seek sheltered employment if other employment is available. The acceptance of sheltered employment by an impaired taxpayer does not necessarily establish his or her ability to engage in substantial gainful activity.

(Secs. 105(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1566; 68A Stat. 917; 26 U.S.C. 105(d); 7805))

[T.D. 7544, 43 FR 19656, May 8, 1978]

§ 7.465–1 Amounts at risk with respect to activities begun prior to effective date; in general.

Section 465 provides that a taxpayer (other than a corporation which is not a subchapter S corporation or a personal holding company) engaged in certain activities may not deduct losses from such activity to the extent the losses exceed the amount the taxpayer is at risk with respect to the activity. For the types of activities to which section 465 applies and for determining what constitutes a separate activity, see section 465(c). Section 465 generally applies to losses attributable to amounts paid or incurred in taxable years beginning after December 31, 1975. For the purposes of applying the at risk limitation to activities begun before the effective date of the provision (and which were not excepted from application of the provision), it is necessary to determine the amount at risk as of the first day of the first taxable year beginning after December 31, 1975. The amount at risk in an activity as of the first day of the first taxable year of the taxpayer beginning after December 31, 1975, (for the purposes of § 7.465–1 through 7.465–5 such first day shall be referred to as the effective date) shall be determined according to the rules provided in §§ 7.465–2 through 7.465–5.

[T.D. 7504, 42 FR 42197, Aug. 22, 1977]

§ 7.465–2 Determination of amount at risk.

(a) *Initial amount.* The amount a taxpayer is at risk on the effective date with respect to an activity to which section 465 applies shall be determined in accordance with this section. The initial amount the taxpayer is at risk in the activity shall be the taxpayer's initial basis in the activity as modified by disregarding amounts described in section 465(b) (3) or (4) (relating generally to amounts protected against loss or borrowed from related persons).

(b) *Succeeding adjustments.* For each taxable year ending before the effective date, the initial amount at risk shall be increased and decreased by the items which increased and decreased the taxpayer's basis in the activity in that year as modified by disregarding the amounts described in section 465(b) (3) or (4).

(c) *Application of losses and withdrawals.* (1) Losses described in section 465(d) which are incurred in taxable years beginning prior to January 1, 1976 and deducted in such taxable years, will be treated as reducing first that portion of the taxpayer's basis which is attributable to amounts not at risk. On the other hand, withdrawals made in taxable years beginning before January 1, 1976, will be treated as reducing the amount which the taxpayer is at risk.

(2) Therefore, if in a taxable year beginning prior to January 1, 1976 there is a loss described in section 465(d), it shall reduce the amount at risk only to the extent it exceeds the amount of the taxpayer's basis which is not at risk. For the purposes of this paragraph the taxpayer's basis which is not at risk is that portion of the taxpayer's basis in the activity (as of the close of the taxable year and prior to reduction for the loss) which is attributable to amounts described in section 465(b) (3) or (4).

(d) *Amount at risk shall not be less than zero.* If, after determining the amount described in paragraph (a), (b), and (c) of this section, the amount at risk (but